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Quantitative Easing, currency market on x-rays

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ECB QE has put tremendous downward pressure on EUR/USD. Where will arrive the exchange rate EUR/USD and CHF in the next 12 months? A comparison between some asset managers's views

On March 9, the European Central Bank (ECB) kicked off its 60 billion euro-a-month (\$66.3 billion) bond purchases. In fact, one week ago the Quantitative Easing (QE) of the ECB began as well as a new era for the euro.

"One of the most important transmission channel of the QE is the currency devaluation", **Andrea Cuturi, Chief Investment Officer, Anthilia Capital Partners sgr**, said. Therefore Cuturi predicts a weaker euro in particular vs the USD. "We expect 0.95 for the end of 2015, while with regards to the CHF we expect a stabilisation of the exchange rate at 1,1", Cuturi added.

One of the effects of QE is to weak the related currency. "This happened for the USD, then the JPY and now the EUR", **Paul Jackson, Head of Multi-Asset Research, Source**, explained, who added that the case of the CHF it was somewhat different. "The JPY is now very cheap, so further downside can be considered to be limited. On the other hand, the USD is in line with historical norms and EUR is only slightly below historical norms (many economists estimate long term fair value of the EUR/USD to be 1.15-1.20) - Jackson clarified - This suggests there is, for the moment, no valuation obstacle to prevent the EUR/USD going quite a bit lower". Jackson see the EUR/USD possibly going to 0.95 in 12 months and at some stage falling into the 0.8-0.9 range (before eventually recovering over the longer term), while the CHF may be overvalued compared to historical norms (especially versus JPY) and this must be damaging the Swiss economy. "We would expect the CHF to decline with the EUR and probably more. CHF became so strong because of Eurozone fears and we would therefore expect it to weaken as economic conditions in the Eurozone improve", he added.

"Regarding the Swiss Franc, the Swiss central bank seems to feel fine as long as EUR/CHF stays in a trading range of 1,00 to 1,10 - **Christian Zima, bond manager of Raiffeisen capital management**, continued - In case it dropped below parity (on geopolitical uncertainties, a Greek EUR exit or any other dramatic deterioration in financial market sentiment), SNB is expected to step in and intervene via buying EUR and selling CHF. If that was unsuccessful in returning the exchange rate above parity again an additional rate cut further into negative territory cannot be ruled out".

In general, according to Zima, ECB QE has put tremendous downward pressure on EUR/USD via making money and bond market investments in the EUR area relatively less attractive leading to rising capital outflows. "There is scant evidence that this is going to change any time soon. Though EUR/USD has already moved dramatically a further fall towards parity seems just a matter of time - he said - However, sooner or later this will have a positive impact on the European economy while negatively affecting US trade. So

some stabilisation around parity is to be expected later in the year with 2016 showing some recovery for the common currency".

Commenting the trend of EUR/USD exchange rate for 2015 **Collin Crownover, Head of Currency Management, State Street Global Advisors** said: "Our view is that there is further weakness to come in EUR/USD, but it will come at a slower pace than the precipitous decline from the 1.39 level in mid-2014. We do believe the US economy will continue to outperform the Eurozone, and that the respective central bank balance sheets will be heading in opposite directions, which will lead to further weakness in EUR/USD".

According to Crownover, much of the ECB's QE is already in the price, "moreover - he added - we see early signs of the Eurozone economic data improving, which will likely lead to a gentler decline in the EUR going forward". His preferred currencies are the US dollar, Japanese yen and British pound. The positive view on the dollar and pound is mostly driven by the same factors: an improving economy and divergence of monetary policy with most of the rest of the developed world, although tightening is unlikely to happen until later in 2015 (US) or 2016 (UK). "Our non-consensus yen bullishness is supported by a combination of the yen being the most undervalued currency in the G10, as well as an economy likely to shake off some of the effects of the consumption tax increase over the next few quarters", Crownover clarified. According to **Viktor Nossek, Head of research of WisdomTree Europe**, the ECB QE is not sufficient by itself to trigger a euro depreciation. "Helping is the Fed's upbeat outlook on US inflation, expecting the oil price effects to have weakened the inflation outlook only temporarily, so that further out, once oil's effect is fully passed through, CPI readings are expected to climb up - he said - Then there is a robust US economy, whose jobs market expansion is broad-based and strong. All these are driving euro-dollar lower, not just QE". Without QE, investor sentiment would have taken a serious hit in the Eurozone, and may have likely also forced the euro lower as a result. "With QE, the asset allocation shift into higher yielding US assets has merely intensified and accelerated", Nossek concluded.